

AUDITOR'S REPORT OF THE AUDITOR-GENERAL TO THE KWAZULU-NATAL PROVINCIAL LEGISLATURE AND THE COUNCIL ON OKHAHLAMBA MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Okhahlamba Municipality, which comprise the statement of financial position as at 30 June 2010, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages [xx] to [xx].

Accounting Officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and in the manner required by the Local Government: Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2009 (Act No. 12 of 2009) (DoRA). This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of South Africa, 1996 (Act No. 108 of 1996) and section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with International Standards on Auditing and *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis for qualified opinion

Property, plant and equipment

7. The municipality did not implement an adequate asset management system resulting in the following material deficiencies:
- Included in additions to property, plant and equipment is work in progress of R15,646 million on which depreciation and accumulated depreciation of R502 981 and R346 345 respectively has been provided. As a result, property, plant and equipment and accumulated surplus are understated by R849 327 and R346 345 respectively and depreciation expense is overstated by R502 981.
 - The municipality incorrectly applied an estimated useful life of 50 years to roads instead of 20 years as per accounting policy note 1.3. Had the correct estimate been applied, accumulated depreciation and current depreciation would have increased by R1,590 million and R846 768 respectively and the surplus for the year and accumulated surplus would have reduced by R846 768 (2009: R1,590 million).
 - The expenditure on projects amounting to R988 549 was not capitalised resulting in, property, plant and equipment and accumulated surplus being understated by R988 549 and accumulated depreciation and depreciation being understated by R49 427.
8. Supporting documentation in respect of expenditure on property, plant and equipment amounting to R8,995 million related to the prior year was not provided on request. This includes the tender documents in respect of infrastructure projects amounting to R8,216 million. Because of the nature of these assets, I was unable to confirm or verify by alternative means the value of property, plant and equipment. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the valuation of assets totalling R8,547 million as disclosed in note 3 to the financial statements.

Operating expenditure

9. The municipality could not provide sufficient appropriate audit evidence to support expenditure of R929 439 (2009: R22,992 million) debited to the operating expenses for the year. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that operating expenses were properly recorded. Consequently, I was unable to satisfy myself as to the occurrence, accuracy and classification of expenditure.

Opinion

10. In my opinion, except for the effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Okhahlamba Municipality as at 30 June 2010 and its financial performance and its cash flows for the year then ended, in accordance with the SA Standards of GRAP and in the manner required by the MFMA and DoRA.

Emphasis of matter

11. I draw attention to the matter below. My opinion is not modified in respect of this matter:

Going concern

12. As disclosed in note 38 to the financial statements the current liabilities exceed current assets by R16,324 million and unspent conditional grants and receipts of R16,240 million are not supported by sufficient cash resources. These conditions together with the other matters described in note 38 cast significant doubt on the municipality's ability to continue as a going concern.

Additional matter

13. I draw attention to the matter below. My opinion is not modified in respect of this matter:

Unaudited supplementary schedules

14. The supplementary information set out on pages xx to xx does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

15. As required by the PAA and in terms of *General notice 1570 of 2009*, issued in *Government Gazette No. 32758 of 27 November 2009* I include below my findings on the report on predetermined objectives, compliance with the following key laws and regulations, Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) and financial management (internal control).

Predetermined objectives

16. Material findings on the report on predetermined objectives, as set out on pages xx to xx, are reported below:

Non-compliance with regulatory and reporting requirements**Inadequate content of integrated development plan**

17. The integrated development plan of the municipality did not include the key performance indicators and performance targets determined in terms of its performance management system, as required by sections 26(i) and 41(1)(b) of the MSA and regulation 12 of the Municipal Planning and Performance Management Regulations, 2001 (MPPMR).
18. The key performance indicators set by the municipality did not include any general key performance indicators applicable to the municipality, as prescribed in terms of section 43(1) of the MSA.

No process plan

19. The municipal council did not, within the prescribed period of seven months after the start of its elected term, adopt a process set out in writing to guide the planning, drafting, adoption and review of its integrated development plan, as required in terms of section 28 of the MSA.

No performance report on service providers

20. The municipality did not prepare a performance report reflecting the performance of each external service provider as required by section 46(a) of the MSA.

Responsibility not assigned to municipal manager

21. The responsibility for managing the process of drafting the IDP was not assigned to the municipal manager by the executive committee as required by section 30(b) of the MSA.

No mid-year budget and performance assessments

22. The accounting officer of the municipality did not assess the performance of the municipality during the first half of the financial year, taking into account the municipality's service delivery performance during the first half of the financial year and the service delivery targets and performance indicators set in the service delivery and budget implementation plan, as required by section 72 of the MFMA.

Late approval of service delivery budget implementation plan

23. The service delivery budget implementation plan (SDBIP) was not approved within 28 days after the approval of the budget as required by section 53(1)(c)(ii) of the MFMA.

Usefulness of information

24. The following criteria were used to assess the usefulness of the planned and reported performance:
- Consistency: Has the municipality reported on its performance with regard to its objectives, indicators and targets in its approved integrated development plan, i.e. are the objectives, indicators and targets consistent between planning and reporting documents?
 - Relevance: Is there a clear and logical link between the objectives, outcomes, outputs, indicators and performance targets?
 - Measurability: Are objectives made measurable by means of indicators and targets? Are indicators well defined and verifiable, and are targets specific, measurable, and time bound?

The following audit findings relate to the above criteria:

Reported information not consistent with planned objectives, indicators and targets

25. The municipality has not reported on its performance against predetermined objectives which is consistent with the approved integrated development plan.
26. The objectives of the approved IDP were not appropriately budgeted for in the SDBIP.
27. The predetermined objectives as reported in the annual performance report were inconsistent with the objectives as per the SDBIP.

Compliance with laws and regulations

Municipal Finance Management Act

The accounting officer did not adhere to his statutory responsibility

28. Contrary to the requirements of section 64(3) of the MFMA, the accounting officer of the municipality did not notify National Treasury of long outstanding debt due by other organs of state for more than 30 days.
29. Contrary to the requirements of section 116(2)(b) of the MFMA, the accounting officer of the municipality did not monitor the performance of contractors.
30. Contrary to the requirements of section 127(5)(a)(ii) of the MFMA, the accounting officer did not invite the local community to submit representations in connection with the annual report in accordance with section 21A of the MSA.

Expenditure was not paid within the parameters set by the applicable legislation

31. Contrary to the requirements of section 65(2)(e) of the MFMA, expenditure was not paid within 30 days from receipt of invoices.

Annual financial statements

32. Contrary to the requirements of section 122(1)(a) of the MFMA, the financial statements submitted for audit were subject to material adjustments due to errors noted during the audit.

INTERNAL CONTROL

33. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the MFMA and MSA, but not for the purpose of expressing an opinion on the effectiveness of internal control.
34. The matters reported below are limited to the significant deficiencies regarding the basis for qualified opinion paragraph, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

Leadership

35. Management has failed to adopt an appropriate tone at the top to ensure that supervision, review and monitoring of the municipality's processes was undertaken, so as to ensure that controls are implemented and functioning effectively and efficiently as well as consistently during the year under review. Control weaknesses that were identified by internal and external auditors were not analysed and appropriate timely follow-up actions were not taken to address the root causes.

Financial management

36. Management did not implement policies and procedures necessary to ensure that performance is monitored and reported. Furthermore, controls necessary to ensure that the financial statements are free of material misstatements were not developed and implemented. Pertinent information was not identified and captured in a form and time frame to support accurate, reliable and complete financial and performance reporting.

Governance

37. Key aspects of ensuring proper governance was absent or inadequate, thus appropriate action was not taken by management to identify weaknesses in internal controls and to mitigate the risks in a timely manner.

OTHER REPORTS

Investigations in progress

38. A forensic investigation is being conducted by the Department of Co-operative Governance and Traditional Affairs to probe the manner in which the municipal finances were used by previously appointed senior management of the municipality. The investigation was still ongoing at the reporting date.
39. Other investigations are being conducted by the Hawks following the allegation of fraud and corruption at the municipality.

Pietermaritzburg

30 November 2010



A U D I T O R - G E N E R A L
S O U T H A F R I C A

Auditing to build public confidence